In The

Supreme Court of the United States

October Term, 1942.

No. .....

GEORGE W. MASON and HAZEL B. MASON, his wife,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

OPINIONS OF COURT AND BOARD BELOW.

The opinion of the Circuit Court of Appeals for the Sixth Circuit (pages 58-61 of the Record) is reported in *125 Fed. (2d) 540.* The opinion of the Board of Tax Appeals (pages 16-22 of the Record) is reported in *41 B. T. A. 1287.*

II.

JURISDICTION.

(1) The date of the judgment to be reviewed is January 14, 1942, and the date of the denial of a petition for rehearing in said cause is March 6, 1942. The time within which to file the petition for certiorari and supporting brief in this case has been extended by this court to and including August 5, 1942.

(2) The statutory provision which is believed to sustain the jurisdiction of this court is Sec. 240 (a) of the Judicial Code as amended, being 28 U. S. C. A., Sec. 347 (a), governing certiorari in the supreme court to review decisions of Circuit Courts of Appeals.

(3) This is a proceeding arising out of the determination by the Board of Tax Appeals of an income tax deficiency which determination has been affirmed by the Circuit Court of Appeals for the Sixth Circuit upon a petition for review. The decision of said Circuit Court of Appeals is erroneous as indicated in Subdivision IV hereof and certiorari should be granted for the reasons set forth in Subdivision V hereof.

(4) The cases believed to sustain said jurisdiction are as follows: *Thomson Spot Welder Company v. Ford Motor Company (1923), 265 U. S. 445, 68 L. Ed. 1098; Forsyth v. Hammond (1896), 166 U. S. 506, 41 L. Ed. 1095; International Railway Company v. Davidson (1921), 257 U. S. 506, 66 L. Ed. 341.*

III.

STATEMENT OF THE CASE.

The facts of the case have been stated in Subdivision I of the preceding petition, pages 2 to 5, inclusive, which Subdivision I is hereby adopted and made a part of this brief.

IV.

SPECIFICATION OF ERRORS.

(1) The Circuit Court of Appeals erred in determining that the market value at the time of receipt of the 4,989 shares of stock which Taxpayer acquired under his agreement to purchase the same constituted compensation for services.

(2) The Circuit Court of Appeals erred in misconstruing Taxpayer's agreement with Kelvinator Corporation so as to disregard portions of such agreement and render portions thereof useless and inexplicable.

V.

ARGUMENT.

SUMMARY OF ARGUMENT.

Point A.

The Circuit Court of Appeals, in determining that the market value of the stock so purchased at the time of receipt constituted compensation for services, has rendered a decision directly in conflict with the decision of the Circuit Court of Appeals for the Eighth Circuit in the case of *Omaha National Bank v. Commissioner (1935), 75 Fed. (2d) 434.*

Point B.

The Circuit Court of Appeals, in construing Taxpayer's contract to provide that the market value of the stock purchased thereunder, at the time of receipt, constituted compensation for services, has so far departed from the accepted and usual course of judicial proceedings and so far sanctioned such a departure by the Board of Tax Appeals as to call for an exercise of this court's power of supervision.

Point C.

The Circuit Court of Appeals, in determining that the market value of the stock so purchased at the time of receipt constituted compensation for services, has decided an important question of federal law which has not been, but should be, settled by this court.

POINT A.

The Circuit Court of Appeals, in determining that the market value of the stock so purchased at the time of receipt constituted compensation for services, has rendered a decision directly in conflict with the decision of the Circuit Court of Appeals for the Eighth Circuit in the case of *Omaha National Bank v. Commissioner (1935), 75 Fed. (2d) 434.*

In the *Omaha National Bank case* an employee of Deere & Company, on November 1, 1911, entered into a combination employment-stock purchase contract with his employer which set forth the terms of his employment over a three-year period at a salary of $5,000.00 annually. In the same contract the employee agreed to purchase stock of the employer corporation under the following provision:

> "Third. *In further consideration of the services so to be rendered by the party of the third part,* the party of the first part agrees to sell, and the party of the third part agrees to buy, all upon the terms and conditions hereinafter set forth, five hundred (500) shares of the common capital stock of the first party, at an agreed price of $50.00 per share * * *." (Italics ours.)

On April 8, 1914, modifications of the foregoing contract were made which are not pertinent to this brief. The agreement of November 1, 1911, was subsequently further modified by another agreement dated April 8, 1918, between the employer, Deere & Company, as first

party, and the employee, as second party, which agreement provided:

> "That a contract between said parties, bearing date of November 1, 1911, and subsequently modified, is now further modified as follows*:
>
> * * *
>
> '3. The first party now agrees to sell and the second party to buy 500 shares of said Deere & Company's common stock of the par value of $100.00 per share, at $50.00 per share, upon the following terms and conditions:
>
> '(a) Said stock shall be paid for (except as hereinafter provided) by first party crediting upon the purchase price thereof, a sum equivalent to the dividends which may be declared upon a like number of shares of Deere & Company's outstanding common stock.
>
> '(b) When the credits so to be made shall equal the sum of $25,000.00, the said stock shall be delivered to the second party, but if the credits do not amount to $25,000.00 by June 1, 1925, the second party shall be entitled to receive, and there shall be delivered to him, 100 shares of said stock; and if by June 1, 1928, the said credits do not amount to the purchase price of the remainder of the stock covered by said contract, the second party shall be entitled to receive, and there shall be delivered to him, 150 shares of said stock in addition to the 100 shares previously delivered, as herein provided. In either or both cases, i. e., on stock delivered in 1925 or 1928, the first party shall credit the second party with the difference between the sum of $50.00 per share and the credits actually made thereon.' "

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*This introductory provision was taken from the transcript of the record which we have secured from the attorneys for the petitioner in the *Omaha National Bank case*. The remaining facts in the *Omaha National Bank case* discussed in this brief are found in the opinions of the Board (29 B. T. A. 819) and the court.

The case involved the taxable gain realized by the employee upon receipt of the 150 shares which he had acquired on June 1, 1928, by reason of a $225.00 dividend credit and a further credit of $7,275.00 under paragraph 3 (b) to make up the $7,500.00 purchase price.

The Commissioner contended that the market value of the stock on June 1, 1928, was compensation for services and therefore taxable income. The court held: (1) that the credit of $7,500.00, consisting of the $225.00 dividend credit and the $7,275.00 credit to make up the balance of the purchase price, constituted compensation for services; and (2) that the stock which the taxpayer was obligated to take in lieu of the $7,500.00 credit was purchased by the taxpayer under the terms of his contract and its market value at the time of receipt did not constitute compensation for services rendered.

The following quotations from the *Omaha National Bank case* are directly applicable to the proceedings at bar:

> "The Board was entirely justified in finding that whatever gain the taxpayer actually realized in 1928 from the contract with his employer was additional compensation for his services, but we are unable to avoid the conclusion that the realized gain was to be measured by what the employer credited the taxpayer with upon his stock purchase contract, and not by the market value of the stock delivered to him. * * *
>
> The Commissioner and the Board have treated the transaction here involved as one in which the company in 1928 delivered 150 shares of stock to the taxpayer as additional compensation for services. They have disregarded the contract. The additional compensation which the taxpayer received was what

he contracted for in 1918 and was the amount credited to him by his employer and with which he paid for the 150 shares of the 500 shares which he agreed to purchase. The difference between the amount of the credit and the fair market price of the stock was not a taxable gain realized in the year 1928, since the stock was not sold by the taxpayer in that year.

Concededly, if the company had, without any previous agreement or understanding, credited the taxpayer with $7,500 and delivered to him the 150 shares of stock as additional compensation for his services, the realized gain would be the fair market value of the stock. * * * But where the stock was delivered under contract of purchase and the taxpayer became the owner of it because of his agreement to purchase, the difference between what he paid for the stock and what the stock was worth was not a taxable gain. * * * It would become a taxable gain in the year that the stock was sold by the taxpayer, provided that the gain had not evaporated by that time.

* * * In this case the employee paid for his stock out of additional compensation contracted for in 1918 for the very purpose of enabling him to pay for at least 250 of the 500 shares by June 1, 1928. There is not the slightest claim or suggestion that at any time the taxpayer and the company acted otherwise than in the best of faith, or that there was any thought on the part of either of avoiding or evading any taxing statute."

It should be noted that in the *Omaha National Bank case* the contract of August 8, 1918, merely modified the November 1, 1911, contract, the 1911 contract prescribing the terms of the employment relationship and also providing for the sale of the stock. For that reason we have an employment agreement and a stock purchase agreement both embodied in one contract. Moreover, the

modified contract provides that on June 1, 1925, the employee shall receive a credit sufficient to pay for 100 shares and that such shares shall be delivered to the employee on that day, and that on June 1, 1928, the employee shall receive a credit to pay for 150 shares and such shares shall be delivered to the employee on that day. There is no question but what these credits constituted compensation for services and the court so held. However, the employee received nothing but stock for such services under the terms of his contract and yet the court determined that such stock was purchased by the employee and not received as compensation for services.

In both the *Mason case* and the *Omaha National Bank case* we have the following elements:

(1) An employment agreement providing among other things for a fixed compensation and prescribing the terms of employment;

(2) A provision in the same agreement for additional compensation, that is, the money bonus in the *Mason case* and the credit in the *Omaha National Bank case;*

(3) A requirement that the amount of such additional compensation (the credit in the *Omaha case* and an amount substantially equal to the amount of the cash bonus in the *Mason case)* be exchanged for stock in the employer company at a fixed price per share on the same day such compensation is received or credited (R. 11-12).

In the proceedings at bar the Circuit Court of Appeals attempted to distinguish the *Omaha National Bank case* on its facts. The distinctions were without foundation under the facts and were of no consequence, even

if they had existed. We believe that we have fully answered these purported distinctions in our petition for rehearing which appears on pages 63 to 75 of the record in this case. If the court believes that there is any merit in such distinctions, petitioners would appreciate this court's considering the matters discussed in the petition for rehearing. We also show in such petition that the facts in the *Omaha case* were far less favorable to the taxpayer than in the proceedings at bar.

POINT B.

The Circuit Court of Appeals, in construing taxpayer's contract to provide that the market value of the stock purchased thereunder, at the time of receipt, constituted compensation for services, has so far departed from the accepted and usual course of judicial proceedings and so far sanctioned such a departure by the Board of Tax Appeals as to call for an exercise of this court's power of supervision.

We have a situation where under the stipulated facts of the case Kelvinator Corporation agreed to sell and Taxpayer agreed to purchase certain stock, there being no evidence that such stock was not sold for a fair price and no evidence that the parties did anything other than what they agreed to do, it being stipulated that taxpayer acquired the stock "pursuant to Section 3" of the contract (R. 10-11). The result of the court's decision is that, if any taxpayer enters into a contract to purchase stock from his employer at a fixed fair price per share, using funds derived from any source but in an amount equal to a portion of his compensation payable at the

date of the purchase, he will be taxed not on the amount of his compensation agreed upon in his contract, but on the market value of the shares at the time of receipt, even though the market value at the time of receipt could not be determined at the time the contract was made. If the courts are permitted to so construe a contract, disregarding portions of it and rendering them useless or inexplicable, then the intent of the parties to such a contract is wholly disregarded and the compensation to be received by the employee is determined to be an amount which neither he nor his employer intended. If the Circuit Court of Appeal's construction is carried to its logical conclusion and the market value of the stock at the time of receipt is less than the agreed fixed purchase price, then the tax should be based upon such lesser price. We believe that the contract has been so misconstrued that it can be said that the Circuit Court of Appeals has so far departed from the accepted and usual course of judicial proceedings and has so far sanctioned such a departure by the Board of Tax Appeals as to call for an exercise of this court's power of supervision.

POINT C.

The Circuit Court of Appeals, in determining that the market value of the stock so purchased at the time of receipt constituted compensation for services, has decided an important question of federal law which has not been, but should be, settled by this court.

As indicated by Point B, the court's misconstruction of the contract in question has a far-reaching effect on all contracts made by taxpayers for purchases of stock

from their employers. We believe that the Circuit Court of Appeals in this case has incorrectly decided an important question of federal tax law which has not been, but should be, settled by this court. In our opinion the question is one of "genuine, intrinsic, public significance."

CONCLUSION.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this court of its supervisory powers by granting a writ of certiorari and thereafter reviewing and reversing said decision.

Respectfully submitted,

COOK, SMITH, JACOBS and BEAKE,
VICTOR C. SWEARINGEN,
Counsel for Petitioners.

Dated July 31, 1942.